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No. 92-466

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

LIGGETT GROUP INC., now named Brooke Group Ltd.,

Petitioner,

vs.

BROWN & WILLIAMSON TOBACCO CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

REPLY BRIEF FOR PETITIONER

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INTRODUCTION

Respondent B&W's brief in opposition to certiorari rewrites the Fourth Circuit's opinion as narrowly "fact bound" and argues that Liggett's Questions Presented are not before this Court.[1] On that first fundamental point, the Fourth Circuit opinion itself proclaims its general application. Second, B&W's brief does not deny the correctness of the main legal propositions framing the Questions Presented. Third, B&W does not deny the essential facts underlying the verdict, but merely restates factual arguments that the jury rejected in finding that B&W's unjustified below cost pricing was likely to be recouped by supracompetitive prices and had a reasonable possibility of lessening competition.[2]

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[1] Reference is made to Pet. at 1 n.1 for Liggett's statement pursuant to Supreme Court Rule 29.1.

[2] Contrary to B&W's assertion, the jury could not have found for Liggett "based on an inference of 'predatory intent,' derived exclusively from statements contained in some B&W internal documents." Opp. at 8. In fact, Instruction 11 required proof of a reasonable possibility of injury to competition which was defined by Instruction 12 to mean "injury to consumer welfare." A7940. Although the jury was instructed that a reasonable possibility of injury to competition could be inferred from direct evidence of "predatory intent," both the fact that could be inferred and the fact from which it could be inferred were strictly limited and defined by the instructions. Instruction 12 stated in part:

> In order to injure competition in the cigarette market as a whole, Brown & Williamson must be able to create a real possibility of both driving out rivals by loss creating price cutting and then holding on to that advantage to recoup losses by raising and maintaining prices at higher than competitive levels. A7940-41.

Moreover, the jury was told that the only intent relevant to this case is one "in which a company plans to discipline . . . rivals . . . so that it can earn higher than competitive profits. . . ." Instruction 19, A7945-46. Thus, evidence of below-cost pricing and a finding of supracompetitive profits were required before the jury could find competitive injury even by inferring it from "predatory intent."

ARGUMENT

1. While the Fourth Circuit's statement of the case noted facts it thought made its theoretical or legal conclusions more plausible, it laid down a general rule applicable to all industries. That rule -- implicitly rejected in this Court and in other circuits -- is that only an actual or potential monopolist or a conspirator can ever engage in price discrimination that has the potential to harm competition. This rule squarely presents the Question whether the reach of the Robinson-Patman Act is limited to Sherman Act violations.

Without denying that competition had been hurt by an acknowledged (Pet. App. at 6a) narrowing of the discount between generic and branded cigarettes, the court of appeals cited the expansion of the generic segment and observed that "the perfect vision of hindsight confirms our . . . theoretical suspicions." Pet. App. at 12a. The court thus relied on the "actual experience in this case" only to buttress the categorical proposition derived from its own "economic logic." *Id.* at 11a.

The following passages from the Fourth Circuit opinion demonstrate that its opinion was based on the generally applicable legal propositions Liggett attributes to it, not on determinations of controverted facts:

> Turning to this case, Liggett has not advanced a theory that Brown & Williamson could ever obtain or maintain monopoly power for any period of time, much less a period sufficient to reap the harvest of its alleged below-cost pricing, since Brown & Williamson never had more than 12% of the agreed-upon market. *Id.* at 10a.
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> Liggett's theory therefore amounts to substituting the conscious parallelism of an oligopoly for conspiratorial agreement or actual monopoly power as the reason Brown & Williamson might rationally expect to be able to recoup its investment in disciplining Liggett. *Id.* at 11a.
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> • • •
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> [I]n the absence of an agreement among the oligopolists, which nobody contends is the fact in this case, membership alone in an oligopoly provides no basis for proof of illegal conduct . . . . To rely on the characteristics of an oligopoly to assure recoupment of losses from a predatory pricing scheme after one oligopolist has made a competitive move is thus economically irrational. *Id.* at 13a.

The jury verdict for Liggett was overturned not because of an absence of proof,[3] but because the Fourth Circuit rejected the legal relevance of the proof on the grounds that a non-monopolist never can be certain of recoupment.[4] The Fourth Circuit thus relied on its view of economic theory to rule generally that an oligopolist acting alone could not violate the Robinson-Patman Act. Indeed, B&W had asked the Fourth Circuit to do precisely that, arguing that as a matter of theory "[r]ecoupment requires the acquisition and sustained exercise of monopoly power" and that monopoly power requires a "single firm" with at least a "dominant share" of the market. B&W's Fourth Circuit brief at 21, 24-25. Because the

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[3] The district court noted that the evidence supported the verdict, apart from the court's own post-trial legal rulings, on which the Fourth Circuit did not rely and which are not at issue here:

> The court's JNOV ruling on competitive injury, causation, and antitrust injury are based upon interpretations of the applicable law. If these interpretations are found to be erroneous and an appellate court applies legal standards more favorable to Liggett, this court does not believe that an examination of the weight of the evidence, the credibility of witnesses and any alleged errors in the admission or rejection of evidence or instructions to the jury would justify granting B&W a new trial. Pet. App. at 19a.

[4] B&W argues that the Fourth Circuit required certainty only on the part of "oligopolists on the sidelines," not of the defendant. Opp. at 16 n.20. But the distinction is meaningless: if rivals have to be certain of each others' reaction before refraining from intense price competition, then supracompetitive oligopolistic pricing would never occur.

Fourth Circuit opinion is not fact bound,[5] it not only presents Liggett's Questions, but also creates the conflicts identified in the Petition.[6]

2. B&W does not deny that the text and legislative history of the Robinson-Patman Act as well as this Court's decisions and proper economic logic provide for liability where there has been unjustified, discriminatory, pricing below average variable cost by a member of an oligopoly who reasonably anticipates that it can recoup its losses by relying on predictable (although not certain) oligopolistic price coordination at supracompetitive levels. While B&W repeatedly describes this as Liggett's theory and as an "academic" possibility, it is in fact B&W's own high-level plan which explained exactly how this single oligopolist could discipline a smaller rival and profit by doing so.

B&W does not deny that the statutory test for primary-line liability is a reasonable possibility of harm to competition at the time the price discrimination is undertaken -- even without conspiracy, monopoly,[7] or actual success.[8] Nor does B&W even

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[5] Contrary to B&W's suggestion, Opp. at 17 n.21, the Fourth Circuit did not take the same approach as the district court. The district court refused to rule out predation by an oligopolist as a matter of law. Pet. App. at 34a. The Fourth Circuit did.

[6] There is a genuine conflict among the circuits upon the need for recoupment. *See* Pet. at 20-22. Liggett accepted the need for potential recoupment and proved it.

[7] B&W quotes an occasional judicial sentence speaking of monopoly as the concern of the price-discrimination statute but offers no reason to reject the statutory language or history. *Compare* Opp. at 27 *with* Pet. at 14-15.

Contrary to B&W's suggestion, the treatise it cites, Opp. at 27, does not insist that the two statutes should be identical in all respects. Rather, it speaks only of an identical price-cost test under both statutes for distinguishing proper from improper prices. 3 P. Areeda and D. Turner, *Antitrust Law* ¶720c, at 190 (1978); *see also* P. Areeda and H. Hovenkamp *Antitrust Law* ¶720'c, at 697 (1991 Supp.).

deny the market-place fact that anticompetitive below-cost disciplinary pricing can be profitable to an oligopolist who is neither an actual or prospective monopolist nor a cartel member.

B&W repeatedly suggests that there is some issue with the existence of price discrimination. There is not. The district judge instructed the jury that price discrimination existed. A7934. Because B&W's cross-appeal of the judge's denial of its conditional demand for a new trial did not challenge this ruling, B&W's attempt to raise it here, Opp. at 7 n.10, is procedurally improper as well as factually insupportable.

B&W suggests that volume-based price discrimination cannot harm competition when available in every geographic region. However, this Court and lower courts have held otherwise,[9] and the Fourth Circuit rested on no such distinction, although B&W contends it did. Opp. at 22. Moreover, the most that price discrimination can do in any case is to facilitate predatory pricing by making it less expensive and by targeting it. Injury to competition is never the "effect" of discrimination directly. Rather it is "the result of a low price which a discrimination in price allowed the defendant to charge." *Shore Gas and Oil Co. v. Humble Oil & Refining Co.*, 224 F. Supp. 922, 925 (D.N.J. 1963).[10]

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[8] B&W argues that the Fourth Circuit did not require success. In fact, the Fourth Circuit either required success or, as Liggett maintains, it ruled categorically that an oligopolist never has a reasonable possibility of injuring primary-line competition. Moreover, contrary to B&W's representation, Opp. at 26, the Fourth Circuit never asked, as this Court requires, whether B&W's conduct had a "reasonable possibility" of injuring competition at the time it was undertaken.

[9] *See, e.g., Utah Pie Co. v. Continental Baking Co.*, 385 U.S. 685, 694-96 (1967) (actionable discrimination included that within a single geographic market); *Holleb & Co. v. Produce Terminal Cold Storage Co.*, 532 F.2d 29, 31, 34 (7th Cir. 1976) (discrimination within Chicago); *Borden Co. v. FTC*, 381 F.2d 175 (5th Cir. 1967).

[10] Although not before this Court, this reasoning also disposes of B&W's allusion to its claim of insufficient "causation." Opp. at 12. On another issue not before this Court, B&W alludes to the district court's

3. While B&W repeats a number of factual claims that it unsuccessfully made to the jury, it does not deny the key facts underlying the jury verdict.

a. B&W does not deny that the cigarette industry is one of the most highly concentrated oligopolies (A7813-15), that brand-name profits are among the highest of any industry (A7006-09, A7896), that they are increasing dramatically notwithstanding falling demand (A7010-11), and that they are protected by high barriers to entry (A7771).[11] While commentators recognize that effective supracompetitive pricing is not always possible even in highly concentrated markets, Opp. at 21, none of them suggests that non-competitive oligopoly pricing is a rarity.

b. B&W does not deny that its expert economist admitted that B&W priced its black-and-white cigarettes below average variable cost[12] for 18 months:

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ruling that Liggett did not suffer antitrust injury. *Id.* However, B&W's antitrust injury argument merely repeats its contention that no violation occurred. Given a violation, however, rivals injured by predatory or disciplinary pricing suffer antitrust injury.

[11] To be sure, Liggett's executives denied that they were aware of any kind of collusion and characterized Liggett's profits as "fair." That businessmen who are not engaged in a conspiracy decline to think of themselves as colluding or gouging the public hardly disproves the evidence that profits in the cigarette industry were at supracompetitive levels. B&W's own economic expert testified that he would not change a conclusion that a market exhibited supracompetitive profits merely because an industry executive testified that profits were fair and reasonable. Transcript at 102:128-29, January 24, 1990. Moreover, when confronted with B&W's below-cost pricing, Liggett's executives naturally considered "competition" -- in the businessman's sense -- more intense. *See* Pet. at 5 n.9.

[12] B&W suggests that such below-cost pricing is not really below-cost because B&W's high profits on branded-cigarettes meant that its revenues exceeded its costs on its total cigarette sales. Opp. at 5. Far from being an excuse, however, the profits on branded-cigarettes support Liggett's contention, based on B&W's own documents, that B&W earned supracompetitive branded profits worth protecting by

> Q. Did B&W price above or below average variable cost in 1984 and 1985?
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> A. Pre-tax trading profit was negative. Therefore, if you disregard financial consequences other than direct sales revenue [i.e., reduced taxes on brand-name cigarette profits] in what you refer to as price, the answer would be that prices are below average variable cost. A7003.

Nor does B&W deny that its contemporaneous financial statements for black-and-whites showed that B&W had a negative trading profit for the eighteen months from its entry into black-and-whites to the close of general discovery, and that negative trading profits meant B&W's prices were below average variable cost according to B&W's own expert economist.[13] A6996, A7616-19, A7003.

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temporarily pricing black-and-whites below-cost.

[13] Precisely because B&W engaged in sustained and unjustified below-average-variable cost pricing its conduct cannot be regarded as a normal price war, as B&W repeatedly suggests. *E.g.*, Opp. at 4, 5, 14. Moreover, B&W from the outset intended to, and in fact did, consistently undercut Liggett during the five-stage "price war." B&W cut prices lower whenever a Liggett response came close to B&W's lower net price to wholesalers. A5914-15.

B&W's counsel asserts that "at no time did B&W ever expect, intend or reasonably anticipate that its black-and-white generics would be unprofitable." B&W Opp. at 4-5. But B&W contemporaneously said that it was "not going into it [black-and-whites] with the objective to make a profit." A1710. In any event, the average variable cost test is an objective test, not a subjective test. The "reasonably anticipated" phrase in the average variable cost test is designed to permit an expanding firm, which reasonably anticipates declining manufacturing costs as volume grows, to use those lower anticipated costs, not its current costs, as the basis for its prices. *See* 3 P. Areeda & D. Turner, *Antitrust Law* ¶715d, at 175 (1978). However, B & W makes no such claim, but instead claims merely that it set its prices lower than it had initially planned. A price-cost test becomes meaningless if the defendant can avoid its reach merely by claiming that it lowered its prices in response to market conditions caused by its own actions.

c. B&W never denies the existence of strong record evidence, both before and after the introduction of Doral,[14] demonstrating that B&W believed it could discipline Liggett by below-cost price discrimination targeted at Liggett's "top 38 accounts" and ultimately "narrow the [discount] gap in generics." A1348, A6130, A6127.[15] B&W wrote that "someone must put a lid on [Liggett] -- if we do -- does someone else need to." A1277.

d. B&W does not deny that it expressly considered whether it could recoup its losses and concluded that it could. B&W anticipated the reactions of fellow oligopolists and calculated that it could save $350 million of brand-name revenue -- which more than recovered its $14 million investment in below average variable cost pricing. A1341-45. Contrary to B&W's repeated assertion, its predatory scheme never rested on any expectation "'that all other oligopolists . . . would simply stand by and refrain from also selling generics.'" Opp. at 21, *quoting* Pet. App. at 11a. Liggett itself proved through B&W's own documents that B&W expected, correctly, that the other manufacturers *would* be "quite likely" to "introduce branded generics, develop loyal franchises, and then gradually raise prices over the longer term." A1419-20. All that B&W's scheme assumed of the others was that they would not interfere with its narrowing of the price spread after Liggett capitulated. They did not.

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[14] The Fourth Circuit noted as consistent with its "economic logic" a B&W memorandum stating "the earlier concern of expanding the economy segment is no longer tenable, given RJR's recent action [in cutting the price of Doral]." Pet. App. at 5a. But that does not speak to the issue of whether B&W intended to discipline Liggett in order to narrow the price spread between branded and black-and-white cigarettes. Indeed that very document states that the major cigarette manufacturers who enter the discount segment "will attempt to manage prices and profitability upward." A1420. Moreover, in subsequent, post-Doral high-level planning documents, B&W reiterated its intent of "reducing [the] percent difference between generic and full revenue brands." A2405.

[15] Although B&W points to Liggett's assets and those of its parent company, Opp. at 29, B&W does not deny that it correctly predicted that Liggett's parent would not tolerate sustained losses on black-and-white cigarettes and that Liggett would ultimately respond to B&W's below-cost rebates by raising list prices.

e. B&W does not deny that the discount between generic cigarettes and full revenue cigarettes fell from 40% in 1985 to 27% in 1989 -- notwithstanding the growth of the reduced price segment[16] -- and all prices rose. Thus consumers paid more for both generic and branded cigarettes. The post-judgment non-record evidence that B&W adduces to show allegedly competitive conditions today is legally irrelevant. Opp. at 6, 10. It does not bear on the reasonable expectations of B&W in 1984-1985 when it priced below average variable cost. Moreover, B&W's use of non-record evidence is procedurally improper and misleading as to current market conditions.[17]

4. In sum, B&W does not deny the possibility of disciplinary predation by a single oligopolist, as proclaimed by its own documents. Nor does it deny facts showing that B&W undertook

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[16] B&W argues that any discount of more than 25% is enough to ensure generic success. Opp. at 11 n. 15. Even if this were true, a discount of 40% would cause the generic segment to expand much faster and benefit consumers much more than a discount of 27%. B&W also emphasizes a 50% discount on so-called sub-generics -- introduced by Liggett -- without disclosing that all sub-generics accounted for less than 1% of the cigarette market at the time of trial. *Compare* Opp. at 6 *with* Pet. at 10 n.15.

[17] B&W's non-record evidence fails to reveal that prices and profits in the cigarette industry have been increasing at record levels in recent years. The very non-record document relied upon by B&W states that cigarette manufacturers "are moving to consolidate the price structure within the price-value segment and reduce the huge amount of discounting and couponing in this area." *Maxwell Consumer Report* (July 1992). "According to the U.S. Labor Department, the tobacco industry's 10% average annual price increases over the past 11 years exceeded those of any other product, including hospital rooms and prescription drugs." Patricia Sellers, *Can He Keep Phillip Morris Growing?* FORTUNE MAGAZINE, April 6, 1992, at 86. Prices for full-revenue cigarettes increased 14.59% from 1990 to 1991. Branded generic prices increased even faster -- 19.32% from 1990 to 1991. (Computed from the *Maxwell Consumer Tobacco Monthly* (January 3, 1992)). Finally, sub-generic brand shares are in decline. *Maxwell Consumer Report* (July 1992).

unjustified discriminatory pricing below its average variable cost with the purpose and effect of disciplining a rival and thereby helping bring about higher market prices, for which its documents take credit. Such facts amply support the jury verdict.

If the Fourth Circuit prevails in ruling that such price discrimination by a single oligopolist never has a reasonable possibility of injuring competition, no plaintiff will ever be able to show a primary-line violation in the absence of monopoly or a cartel. That disciplinary pricing has seldom been litigated merely reflects the difficulties in distinguishing proper from improper pricing. Of course, the Fourth Circuit's view assures that there never will be such litigation -- no matter how clearly the evidence of a genuine threat to competition emerges from sophisticated planning documents and conduct.

B&W suggests that issues presented in this case are unique. They are not. All that is unique here is the clarity with which the defendants own high-level documents make plain that its conduct was predatory and could injure competition. This kind of uniqueness makes the case particularly appropriate for Supreme Court review.

CONCLUSION

For the reasons stated above and in Liggett's Petition, Liggett respectfully re-urges the Court to grant certiorari.

Respectfully submitted,

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